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CoreCard Corp. (CCRD)

Q3 2022 Earnings Call

Executives

James Leland Strange
Chairman, President & Chief Executive Officer, CoreCard Corp.

Matthew A. White
Chief Financial Officer & Corporate Secretary, CoreCard Corp.

Analysts

Anja Söderstrom
Analyst, Sidoti & Company, LLC

MANAGEMENT DISCUSSION SECTION

Matthew A. White
Chief Financial Officer & Corporate Secretary, CoreCard Corp.

Thank you. Good morning, everyone. With me on the call today is Leland Strange, Chairman and CEO of CoreCard Corporation. He will add some additional comments and answer questions at the conclusion of my prepared remarks.

Before I start, I'd like to remind everyone that during the call, we'll be making certain forward-looking statements to help you understand CoreCard and its business environment. These statements involve a number of risk factors, uncertainties and other factors that could cause actual results to differ materially from our expectations. Factors that may affect future operations are included in filings with the SEC, including our 2021 Form 10-K and subsequent filings.

As we noted in our press release, our third quarter results were in line with our expectations. Total revenue for the third quarter of 2022 was $14.5 million, a 12% increase compared to the third quarter of 2021. The components of our revenue for the third quarter consisted of professional services revenue of $7.8 million, an increase of 12%. Processing and maintenance revenue of $5.3 million, an increase of 52% and third party revenue of $1.4 million. Services revenue, which represents total revenue less license revenue grew 30% for the third quarter of 2022 compared to the third quarter of 2021, led by 52% growth in our processing and maintenance revenues. We continue to onboard new customers both directly and through various partnerships we have with program managers such as Deserve, Vervent. and Cardless.

We currently have multiple implementations in progress with new customers that we expect to go live in the coming months. We are working on launching a new program with an existing customer Cardless on a co-branded card with American Express and Simon, which is a real estate investment trust that owns shopping, dining, entertainment and mixed use properties. It is an S&P 100 company. Once live, we will have a direct connection with American Express, similar to what we have with Visa and MasterCard today. And we'll be able to process other customers who want to use the American Express Network. We completed the American Express certification process in October, and we expect this program to be live later this month.

We were happy to have recently announced the addition of Kathryn Petralia to our Board of Directors. Kathryn brings extensive fintech experience to our board and was a Co-Founder of Kabbage, a customer that we've talked about previously and that was acquired by American Express in 2021.

We've recently finalized a new contract with American Express to process its AMEX Kabbage loans, and we've seen steady growth in this new program. Separately, we continue to service legacy Kabbage loans under the K-Servicing name. As discussed previously, these legacy and PPP loans continue to run off as the loans are paid off or forgiven. We recognized revenues of approximately $0.5 million for the third quarter from this customer and expect the runoff to continue at a faster pace going forward as K-Servicing announced its intentions to wind down.

I'll now dive deeper into the results for the quarter. Processing and maintenance revenues grew 52%, as I mentioned, in the third quarter of 2022 compared to the third quarter of 2021 from the recently added customers mentioned above who are now live and continued growth from existing customers. Revenue growth, excluding our largest customer, was 22% in the third quarter of 2022 compared to the third quarter of 2021. As a reminder, we typically charge for our services based on the number of accounts on file, not transaction volume. As a result, we expect our processing revenues to be resilient during weak periods of economic growth or during economic declines.

Turning now to license revenue, as expected, we did not recognize any license revenue in the third quarter of 2022. However, we do expect a new license tier in the fourth quarter of 2022. Professional services revenue remained strong in the third quarter. We anticipate professional services revenue in the fourth quarter in the range of $6.7 million to $7 million. We consider this revenue to be repeating as evidence now by four plus years of significant growth in professional services. However, there are still fluctuations quarter-to-quarter, and we can still have both positive and negative surprises from what we expect, although we don't anticipate any large surprises either way.

Turning to some additional highlights on our income statement for the third quarter of 2022. Income from operations was $1.7 million for the third quarter of 2022, compared to income from operations of $3.3 million for the same time last year. The decline primarily relates to lower license revenue in the 2022 period, as we've said previously, our license revenue is lumpy and it can have a significant impact on our results.

Our operating margin for the third quarter of 2022 was 12% compared to an operating margin of 26% for the same time last year. The decrease is primarily driven by lower license revenue and continued hiring in India and in our Colombia office that we opened in October 2021.

Our third quarter 2022 tax rate was 24.6% compared to 26.3% in the third quarter of 2021. Earnings per diluted share for the quarter was $0.16 compared to $0.29 for Q3 2021.

We remain optimistic about our long-term prospects and believe the investments we've made in our infrastructure and in hiring and training new people will continue to yield new customer wins and revenue growth. Due to our solid performance through the third quarter of 2022, we're confident in top line growth expectations of at least 40% for fiscal 2022 compared to our previously provided guidance of at least 30%. The opportunity ahead of us is significant and CoreCard remains a growth business focused on meeting the evolving needs of modern issuers while generating long-term value for our shareholders.

With that, I'll turn it over to Leland.

James Leland Strange

Chairman, President & Chief Executive Officer, CoreCard Corp.

Okay. Thanks, Matt. It's a – it's a beautiful fall day in Atlanta with the leaves turning both on the tree and on the ground, a lot of color. So let me add a little color here about what Matt said about the company. By the way, I hope it's beautiful where you are, too, and have the same smile we do as we look out on this beautiful weather. I'll give you some of my views on the quarter and 2022 year-to-date as well as opine on what to expect for this quarter and then some for next year. My comments really should not be interpreted as any kind of forward guidance, as I'm speculating on how things will unfold from where I sit today, and they always can look different tomorrow. As I said, the weather looks great today. It may not be the same tomorrow. Matt gave you the highlights for the quarter. Maybe my first comment will be what we could call lowlights, and then I'll move on to the highlight color. And I would say the lowlight would probably be consider the expense growth in what may appear to be margin issues. There's no question our expenses have continued to grow, and they grow actually at a faster rate compared to our non-license revenue. Most of that growth was planned. It's all in cost of people. Salary inflation is typically about what we will expect long term. But I really don't expect it to moderate until perhaps the middle of next year. We are intentionally bringing on more people to be ready for more growth in the coming years. You've heard me in the past talk about how long it takes to train to be able to offer our customers and partners the quality and high-end expertise that differentiates us from others. For us the 18 months of training suffices, but for others it will be a three-year process. We've now caught up in the sense we have a steady process to what label as to grow at a steady 20% to 25% rate that I've originally stated that should be a practical limit for a responsible fintech company. By the way, when I say 20%, 25%, I would say over any five-year period that should be our annual growth. There'll be ups and downs and I'll add just as quickly that 2023 is not likely to grow by that point. And more on that comment later.

Let me expand on the employed topic a bit more. We now have over 1,200 employees. I think this month four years ago, we had about 430 employees. So, we triple the number moving at a very rapid pace at an average if we add this past year roughly.

Matthew A. White

Chief Financial Officer & Corporate Secretary, CoreCard Corp.

So far through September, we've added 300 employees, mostly in India.

James Leland Strange

Chairman, President & Chief Executive Officer, CoreCard Corp.

So that's a 25% increase, a 30% increase already this year. So, I used the word "caught up" earlier mainly to represent how we now feel that we have a stable environment for recruiting, onboarding and training. All of this growth came with the dislocating factors brought on by COVID and also work from home. I'd say we're also caught up on stabilizing the environment from that perspective with our major current opportunity being facilities for the employment growth and dealing with the continued poaching of our trained employees for larger companies. I think I should pause to give the highest compliments and praise to the President and

General Manager Anupam Pathak of our India operations for his leadership through this growth. He's also one of the primary architects of our CoreCard platform and has just done a marvelous job. I guess some other facts that we shared with the board yesterday about our employees is that we have a large number of employees who have been with CoreCard for over five years and actually many over 15 years. But the numbers for over five years are 200 plus in India, 20 in the US and six in Romania.

I will have to both as a significant shareholder and also as CEO say I am very thankful for their loyalty and dedication to the success of the platform that they themselves built. Only a good team can make things happen, and perhaps of all the characteristics of an organization such as ours, teamwork is the most important. We just have a remarkable group of talent, energy and longevity.

With that background on expenses, margin and employees, now what? Earlier I alluded to the fact that my prediction of 20% to 25% growth over any five-year horizon would be my expectation. How does that play into this year when Matt just said he expected growth this year to be in the range of 40%?

Well, it really doesn't change my expectations in addition to lumpy quarters, you'll get lumpy years because of license revenue is booked. I know some of your probably tired of hearing the word lumpy, but it is what it is, and we make business decisions on what is best to grow the business, not in modeling it for Wall Street. We're still of the old Warren Buffett school, just mind the business. We run a business, not a business plan. I suspect that this year is our largest license revenue year historically and perhaps will be our largest year ever. But when you have a year like that, you could expect that to be lumpy, and that poses issues in comparisons. There's a good chance we'll get more license revenue in the fourth quarter, and if not definitely in the first quarter of next year. I think you would understand if I said I hope it gets delayed in the first quarter as our 2023 first quarter comparison will be against this year's very large first quarter of over $12 million. The comp of that is the way we're likely to hit $16 million in license revenue in 2022. And that's why I said it's probably the largest we've ever had and probably the largest we’ll ever have. Of course, I wish some of the first quarter this year had come in the fourth quarter last year to smooth out results to make Wall Street happier. But I think, you know by now we've managed to a longer term to take it as it comes. And shareholders who want steady growth over several years are comfortable with us as we have and will deliver those kinds of returns and those that want to manage the numbers for charter are not going to be very happy. I can categorically state that we will not be anywhere close to $60 million in license revenue in 2023. My best guess at this point is that it will be between $3 million and we'll say $7 million. And that leaves a big top line in earnings hole to fill in 2023 in comparison to 2022. Remember that license revenue all drops to the bottom line in terms of gross profit, in terms of net profit, really. Can we fill that hole? Surprisingly, filling that hole is definitely possible and possibly even to beat it. But that's not a prediction at this point in time. How do we do it if we do it? Well, currently we have potential partners that may license or may want to be processed. If they license, we get more up front. If they choose processing, we have more up front expense and infrastructure and then the monthly numbers just add up over time.

We can't predict their choices of this time, so I cannot predict how that will play out. There's still another factor, and I know that because they told me they listen to these calls and that's a company that we chose not to take on, is wondering why we did not take them on, if we might have a revenue hole. The answer to that is that we continue to choose customers based on their strategic value to us, over the long haul. We want to devote the scarce resources to the most profitable, long-term, value creating opportunities. So, do we have many or enough of those? I'm going to say YES! And that should be put in capital letters in the transcript.

Matt talked about some of the newer customers, each with a particular value to us, and also the opportunities they bring to increase our processing revenues. There are others in addition to those he talked about that we expect to go live in the fourth and the first quarter. They're combinations of fintechs with particular needs, and large corporations that are going to provide cards to their customer base.

Large corporations almost always start small to test their offerings before large rollouts. It is the right way to do it.

If they roll out faster than even I would recommend, they can fill their revenue and earnings hole faster.

What about larger opportunities? We fully expect by this time next fall have either announced or been working on one or two large programs. They'll either be the direct CoreCard or through current partners such as Goldman or through new ones currently in discussion stages brought to us by other current program managers.

We have sufficiently trained and skilled resources to take on two decent sized projects by this time next year and probably end up with three or four good sized projects by 2024. In terms of current discussions, there are a mix of licensees and processing potential customers. We are incurring the personnel expenses currently to be able to make that happen. Of course, if processing we will still have to add more infrastructure costs to take that on. We can't take on three big ones successfully next year while still serving the strategic newer fintechs. And as we've said before, we will not take on business that we are very cautious as to our ability to successfully implement or serve. So don't expect more than two next year in some combination.

Matt pointed out that our processing and maintenance revenues grew 52% in this quarter compared to last year's the same quarter. Now, I'm not going to project 50% each quarter, but I can comfortably say we'll have significant growth in this recurring revenue line next year, even though license revenues will be significantly down. For many shareholders, this is what they want to see, and they actually discount the license revenue income. I don't do that, but I know many do.

Goldman Sachs is recognized in our filings, as our largest customer. And the Goldman CEO has recently stated that their customer Apple has renewed their contract until the end of the decade. I expect the Goldman concentration to be coming down next year as we grow the other businesses. But that does not mean we expect to lose Goldman business. Although I have said for some time, don't be surprised if they take a simple card program to a legacy processor in order to diversify their reliance on CoreCard.

As their portfolios and card counts grow, while we serve them well and they remain our number one priority for best resources, we do have growth challenges as they themselves also have. They are a great, highly professional, highly talented organization and our partnership has made CoreCard infinitely better as a result of that association.

If they were to choose to bring another program under the CoreCard platform. And if that program has a current base of cards that requires conversion, which, by the way, we're very good at, we would see more license revenues and perhaps maintain current professional service revenues at the current pace. If it were a new program, then the license revenue be more spread out with the program growth we would see a dip in professional services. I might add that fourth quarter, this fourth quarter, with the holidays usually portends a dip in professional services work as you have fewer hours available since people take holidays.

I think Goldman has stated in their own in their own earnings calls that they want to take 2023 to stabilize their consumer offerings before growing them again.
As I've said earlier, we're planning on two larger customers by this time next year. Goldman may or may not be one of them, but we can only do two. I hope I've given you what you need to know as you make their ongoing investment decisions. We're conservative because we want our customers to always be able to trust us. We're a company that believes in doing what's right, regardless of the construct of the contract and it's really not unusual for us to suggest, before anyone else brings it up, that our terms should be modified and even what the customer pays should be reduced. We also sometimes step up and may offer the creditor benefits that we're not in any way contractually obligated to do if for some reason we have unilaterally messed up. We want to do what's right even as we become much larger and not hide behind process.

Now before you as shareholders get concerned with that statement believing we're easy and roll over, you could just as easily find examples where we are tough as nails because we simply want to get paid for the good value that we provide. Pay us the right amount at the agreed upon time. We simply want to be known as 100% completely, totally trustworthy. And we want to be known as that by our actions and not by our slogans. Your choice if you want to correlate that statement with the fact that we still have no salespeople that I'm aware of in the 1,200 plus employees. And by the way, I say that and end here with a smile as we open it up for questions. Still no salespeople among the 1,200 employees, he said with a smile.

Operator, you can open it up for questions if you like.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now conduct the question-and-answer session. [Operator Instructions] One moment while we pool for our first question.

James Leland Strange
Chairman, President & Chief Executive Officer, CoreCard Corp.

A

Hey, we're happy if there are no questions, because as shareholders know, they can always call Matt or I to – to get answers. So, if you don't have any at this point, why don't we just have...

Operator: We do have a question that just came through...

James Leland Strange
Chairman, President & Chief Executive Officer, CoreCard Corp.

A

Okay.

Operator: ...from Anja Soderstrom with Sidoti. Please proceed.

Anja Söderstrom
Analyst, Sidoti & Company, LLC

Q

Hi, Leland. Hi, Matt.

James Leland Strange
Chairman, President & Chief Executive Officer, CoreCard Corp.

A

Hi, there.

Anja Söderstrom
Analyst, Sidoti & Company, LLC

Q

Thanks for taking my question. I'm just curious if you can talk to some of the magnitude you see, you know, you don't think you might lapse the license booking you had this year in -- in the coming years. But you're talking about potential two new customers --licensed customers at the end of next year. Could you just talk about some of the magnitude of those? Are they going to be slowly building out because they are new customers or is it the transverse? It could be a little bit larger than just building up from scratch or?

James Leland Strange
Chairman, President & Chief Executive Officer, CoreCard Corp.

A

Yeah, right. Right now, it's hard now. We're talking -- we are -- our partners are talking to some of the how portfolios that would be converted at the end of next year. First of all, that means there will be a big lump. But we're also talking to those that are just going to build up over time and we're talking to some that are highly likely to have a license, but it will be smaller and may even be international. So, it's really hard for us to project how we're going to fill that hole.

And I know you've got to model this, so we'll try to we'll try to help with what we know. But it's really difficult to know the combination. Matt, do you have any other comments on that?

Matthew A. White
Chief Financial Officer & Corporate Secretary, CoreCard Corp.

A

I think your comments earlier about if it's a processing customer, it a little slower as they add accounts to the platform. If it's a license customer, you get that license revenue maybe more upfront you know, a lot of that depends on timing, though, of the go-live, which we don't-

James Leland Strange
Chairman, President & Chief Executive Officer, CoreCard Corp.

A

I think what she's asking is, though, is how much of each are we going to have? And I think what we're saying, we don't know right now. We just believe between the combinations of those are we're talking to that we can fill up that hole or a large part of that hole. But we don't know whether it will be license or processing right now.

Anja Söderstrom
Analyst, Sidoti & Company, LLC

Q

Okay. Thank you. And then in terms of the license revenue you do expect in the fourth quarter, is that some from both the GM and the Apple or is it just one of them?

James Leland Strange
Chairman, President & Chief Executive Officer, CoreCard Corp.

A

It will, well, we don't separate. Remember our customers is Goldman. It's not Apple or GM. So, the license revenue would come from Goldman Sachs, not from them.

Matthew A. White
Chief Financial Officer & Corporate Secretary, CoreCard Corp.

A

It's from growth in existing programs.

James Leland Strange
Chairman, President & Chief Executive Officer, CoreCard Corp.

A

So, it could be any combination of that growth between them.

Anja Söderstrom
Analyst, Sidoti & Company, LLC

Q

Okay. Okay. Got it. Thank you. That was all for me.

James Leland Strange
Chairman, President & Chief Executive Officer, CoreCard Corp.

A

All right. Thank you.

Operator: There are no further questions in queue at this time. I would like to turn it back to management for closing comments.

James Leland Strange
Chairman, President & Chief Executive Officer, CoreCard Corp.

Okay. Thank you, everyone, for your interest in the company and we appreciate that interest as usual. If you have any further questions that we'll be able to answer, please contact us directly. So, thank you to everybody. Have a great, nice fall day. Bye.

Operator: Thank you. This does conclude today's teleconference. You may disconnect your lines at this time and thank you for your participation and have a great day.